

Federal Budget Review

2018 Miller Thomson Federal Budget Review

February 27, 2018

With today's tabling of the 2018 Federal Budget (the "Budget"), the federal government followed through on its previously expressed commitments to reform the taxation of passive income earned by certain private Canadian corporations. It has also continued to "tighten" the Canadian tax system by closing perceived "loopholes" and by proposing enhanced reporting and disclosure obligations for trusts and beneficial ownership. Although the federal government has sought to remedy the perceived lack of fairness in the existing tax rules as they relate to certain private Canadian corporations, the measures proposed in the Budget represent a more tempered approach and, of the Federal Government's own admission, an "important departure" from the July 2017 proposals.

The most significant developments from the Budget that will particularly impact tax planning for Canadian businesses, business owners and high-net worth individuals include:

- **Taxation of Private Corporations** – Proposed changes to the taxation of passive income earned by a "Canadian-controlled private corporation" ("CCPC") on its retained earnings which would have benefitted from the small business deduction under the *Income Tax Act* (Canada) (the "Act"), most notably:
 - the reduction of a CCPC's presently available \$500,000 small business income deduction limit by \$5 for every \$1 of investment income above a \$50,000 threshold; and
 - the creation of two separate refundable dividend tax on hand ("RDTOH") accounts and a limitation of RDTOH refunds to payments of non-eligible dividends;
- **Enhanced Reporting for Personal and Family Trusts** – As part of an overarching commitment to track beneficial ownership information (which is to be extended to corporations in due course), commencing in 2021, subject to exceptions, there will be enhanced reporting requirements for Canadian express trusts (generally, a trust created by express intent and not a constructive trust or a trust created by statute) and non-resident express trusts which are deemed residents of Canada under the Act, including the disclosure of the identities of the settlor(s), trustees and beneficiaries of such trusts, as well as the identities of any other persons (such as a protectors) who may exert control over trustees with respect to the appointment of income and capital;
- **"Tiered" Partnership Structures** – A proposed change to overturn the recent decision in the *Green* case to clarify that the Act's "at-risk" rules (which generally limit the extent to which a limited partner of a partnership may deduct losses of the partnership allocated to the limited partner) apply in the context of a tiered partnership structure, in which a partnership is itself a limited partner of another partnership;
- **Cross Border Surplus Stripping by Partnerships and Trusts** – Proposed changes to include comprehensive "look-through" rules in the Act to address a non-resident of Canada's use of partnerships and trusts to extract, on a tax-free basis, a Canadian corporation's surplus in excess of the paid-up capital ("PUC") of its shares, or to increase the PUC of its shares;
- **Foreign Affiliates and FAPI** – Proposed changes to the Act's foreign affiliate and foreign accrual property income ("FAPI") régimes to target certain "tracking arrangements" (in which Canadian taxpayers "group" their respective financial assets in a common foreign affiliate to carry on investment activities outside of Canada so that each contributing taxpayer retains control over its contributed assets and any returns from those assets accrue to its benefit) which are used to prevent offshore investment income of a Canadian taxpayer from being characterized as FAPI of the taxpayer; and
- **Statutory Reassessment Periods** – Proposed changes to the Act's reassessment periods to:
 - add a "stop-the-clock" feature in situations where taxpayers contest Requirements for Information issued by the Canada Revenue Agency (the "CRA") under the Act and/or compliance orders sought by the CRA; and
 - extend by three years the reassessment period applicable to a prior taxation year of a taxpayer if a reassessment of the taxpayer results in the reduction of a loss which the taxpayer had previously carried back to that prior taxation year, and the loss relates to a non-arm's length transaction between the taxpayer and a non-resident of Canada.
- **GST/HST** – Changes to the draft legislative proposals released in September 2017 in relation to the application of the GST/HST to investment limited partnerships. The September 2017 proposals will be amended to clarify that GST/HST applies to management and administrative services rendered by the general partner of an investment limited partnership on or after September 8, 2017. Management and administrative services rendered by the general partner before September 8, 2017 will not fall within these rules unless the general partner charged GST/HST in respect of such services before that date. The tax will be payable on the fair market value of management and administrative services rendered by the general partner.

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